HOUSEHOLD DEMAND FOR ISLAMIC FINANCE IN SELECTED COUNTRIES

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Abstract

The term Islamic Finance (IF) can generally be defined as the provision of financial services and products on the principles of Islamic shariah (law). Some basic principles of Islamic Finance are prohibition of riba (interest), gharar (uncertainty), and gambling. Another defining characteristic of Islamic Finance is that it is supposed to link financial transactions with activities in real economy and arrange for sharing of entrepreneurial risk. It is predicted by the International Organization of Securities Commission that by 2015, investments undertaken according to these principles will account for half of the savings of the world's estimated 1.2-1.6 billion Muslims. Yet, we have very little insight into economic preferences of Muslim populations living in Western societies when it comes to shariah compliant investment opportunities. A 2010 report on Islamic Housing Finance in Canada commissioned by the Canada Mortgage and Housing Company notes that without such information it is impossible to understand how market demand would respond to an ever growing array of Islamic Finance products and services. This paper documents some stylzed facts about housing choices of immigrants in Italy as well as providing some comparison of the UK and the Canadian context. This is intended as a first step in uncovering household preferences for various investment alternatives among Muslim population in selected Western economies.

Key Words: Housing, Investment, Immigrants, Islamic Finance

Introduction

According to a report published in 2009 by Pew Forum on Religion & Public Life on the size and distribution of world's Muslim population, nearly 40 million Muslims live in Europe. In particular, Germany and France have the largest population of Muslim minorities in the euro area at over 4 million and 3.5 million respectively. In light of these figures, it is an interesting question how household portfolios in these large European economies might have responded to the strong global growth of Islamic Finance since its inception in modern form four decades ago. Given that almost all multinational banks offer some sort of Islamic financial assets alongside conventional financial assets, the effect on household portfolio decisions might also extend to those investors looking for an "ethical" finance alternative regardless of their religious background.

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Understanding consumer preferences for this particular sector of alternative finance can also help shed light on investor preferences for Socially Responsible Investment (SRI). Socially

Responsible Investment is a fast–growing financial sector that manages more than 3 trillion US dollars in US alone according to the 2010 Trends Report. Its relevance to Islamic Finance from an investment strategy perspective lies in the overlap of their screening procedures that prohibit financing businesses such as weapons, tobacco, and pornography. This common ground appears to be a major marketing and public relations point for Islamic Finance especially in European countries such as France where the term Ethical Finance is favored over Islamic Finance in part to fend off negative public opinion over the religious connotation.

Main Text

The 2012 Islamic Finance Guide reports that real estate sector dominates the most recent market developments in Islamic Finance in countries such as UK and Canada. Home ownership remains an important financial goal among the Muslim population in Canada, which is projected to triple in the next 20 years to account for 6.6% of Canadian population by 2030 according to a recent report by Pew Forum on Religion and Public Life. In UK, one of the contributing factors to the development of the housing sector of the Islamic Finance market was the 2004 abolishment of double stamp duties resulting in more competitive shariah compliant mortgages. Another important development in 2004 was the launch of Islamic Bank of Britain as the first standalone Islamic Bank in the Western world with the approval of the Financial Services Authority. Currently, there are about 20 banks providing shariah compliant products and services through Islamic windows including some big banks such as HSBS and Lloyds TSB. Consequently, UK established itself as the leading European country in Islamic Finance activities. The UK experience can provide a useful road map for considering how the expansion of Islamic Housing Finance fits within the current Canadian legal, regulatory and tax framework.

In contrast to UK, currently there are no Islamic Banks or windows operating in Italy. Nevertheless Italy remains an interesting case due to government involvement in producing detailed market studies to promote the country as a viable market for Islamic Finance. The country report published in the 2012 Islamic Finance Guide mentions the availability of extremely detailed surveys and market analyses categorized by the countries of origin and the banking services used by the Muslim community in Italy. These data could be utilized to study financial behavior of the Muslim community to fill the existing gap in our knowledge of consumer preferences toward alternative investment opportunities. Such a study could provide interesting insight since the Italian Muslim population is characterized by a variety of countries of origin and not dominated by a single nationality more like the Canadian Muslim population.

The 2011 Italian Report on Migrations provides interesting statistics comparing housing situation of immigrants and Italians. The report is based on Income and Living Conditions survey study conducted by Istat (Italian National Institute for Statistics) in 2008. In the survey, the immigrant status is defined by country of birth where those born outside of Italy are classified as either EU immigrants or extra-EU immigrants. According to statistics provided from the survey, renting or subletting is most common among extra-EU immigrants with 58.8% compared with only 16.1% of renters among Italians. In contrast, a high percentage of Italians are homeowners. Specifically, 71.4% of Italians live in a house they own whereas only 28.4 of extra-EU immigrants are homeowners. In both cases, the figures for EU immigrants fall in between the two although their housing situation resembles that of other immigrants more closely. The survey also provides information on mortgages and other loans homeowners take out for purchase or renovation as well as the interest rates carried on these loans.

The figures provide a very interesting comparison on relevant economic data and indicate further investigation into possible sources of the difference in housing situation is worth undertaking. The literature on determinants of homeownership provides evidence that certain demographic factors such as marital status and financial variables such as income uncertainty have significant effect on homeownership rates. For example, Fisher and Gervais (2011) show that most of the decline in number of young homeowners in US between 1980 and 2000 can be explained by increasing income risk and an increasing trend for marriage age observed during the same period. In the Italian population surveyed by the Italian National Institute for Statistics, employment stability appears to be different between Italians at 10% and immigrants at 15%. Whether the observed variation in employment stability could have a similar causal effect on home ownership as income uncertainty is an interesting question that deserves further investigation. Marriage status should also be investigated as a potential determinant of difference in homeownership across immigrants and Italians.

It should be stated that although the survey sheds light on some important aspects of the housing status of immigrants in Italy vis-à-vis Italians, it stops short of identifying the immigrant's country of birth. It also provides no information on religious affiliation. Therefore, it is not possible to quantify the casual effects of any ethical considerations based on religious affiliation on home ownership decision. The next step in uncovering household preferences for various investment alternatives among Muslim population in Western societies is control for these factors using datasets that collect demographic and financial variables for groups of households with different religious affiliations.

Conclusion

In a nascent industry like Islamic Finance that existed in its modern form only for the last 30 years or so, availability of public data accessible through well established and clearly announced procedures remains a challenge for empirical research. Increased interest in understanding household preferences for Islamic Finance by both the industry and the academic circles is encouraging for collection, distribution, and analysis of relevant data.

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